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Legislative Audit Division

State of Montana

Report to the Legislature

November 2001

Financial Audit

For the Fiscal Year Ended June 30, 2001

Montana State Fund

We performed a financial audit of the Montana State Fund for the fiscal year ended June 30, 2001. This report contains the audited financial statements and accompanying notes for fiscal year 2000-01, with comparative fiscal year 1999-00 amounts. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

This report contains no recommendations.

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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1999, was issued on March 30, 2000. The Single Audit Report for the two fiscal years ended June 30, 2001, will be issued by March 31, 2002. Copies of the Single Audit Report, when available, can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

November 2001

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the financial audit of the Montana State Fund for fiscal year 2000-01. The objectives of this financial audit include determining if the financial statements for fiscal year 2000-01, with comparative financial amounts for fiscal year 1999-00, present fairly the Montana State Fund's financial position at June 30 for each fiscal year and the results of its operation for the fiscal year then ended. We tested compliance with laws that have a direct and material effect on the financial statements.

Montana State Fund is a workers' compensation insurance company established by the state of Montana. It is a nonprofit, independent public corporation that provides Montana employers with an option for workers' compensation and occupational disease insurance. Montana State Fund is governed by a seven-member board of directors appointed by the Governor. State law separates funding sources for claims incurred before July 1, 1990 (Old Fund) and those incurred on or after July 1, 1990 (New Fund).

Montana State Fund management must set premium rates at amounts sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet the reasonable expenses of conducting the business of the New Fund, and to maintain an excess of surplus over the amount produced by the National Association of Insurance Commissioners' risk-based capital requirements for a casualty insurer. The Old Fund costs are currently funded by investment earnings. The investments of the Montana State Fund are managed by the Montana Board of Investments and invested according to policies established in law. The prior audit report included one recommendation to Montana State Fund. We found the recommendation has been implemented.

On page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the presented information. Montana State Fund's response to our audit is on page B-1.

We thank the Montana State Fund staff for their cooperation and assistance during the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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Appointed and Administrative Officials

Montana State Fund	Carl Swanson	President/CEO
	Mark Barry	Vice President, Corporate Support
	Lanny Hubbard	Vice President, Insurance Operations
	Jill Lotter	Vice President, Insurance Operations Support
	Nancy Butler	General Counsel

State Fund Board of Directors		Term Expires
	Herb Leuprecht	2005
	Tom Horn	2003
	Loretta Lynde	2003
	Wendy J. Susott	2003
	Derek Grewatz	2005
	Susan Knedler	2005
	Robert Cope	2005

For additional information concerning the Montana State Fund, contact Carl Swanson, President/CEO, at:

5 South Last Chance Gulch
Helena MT 59601
(406) 444-6501

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheets, New Fund and Old Fund, of the Montana State Fund, a component unit of the state of Montana, as of June 30, 2001 and 2000, and the related Statements of Operations and Changes in Fund Equity, New Fund and Old Fund, and Statements of Cash Flows, New Fund and Old Fund, for each of the fiscal years then ended. The information contained in these financial statements is the responsibility of the Montana State Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Fund as of June 30, 2001 and 2000, and the results of its operations and of its cash flows for the two fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

October 18, 2001

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MONTANA STATE FUND - NEW FUND
BALANCE SHEET
The State Fund is a component unit of the State of Montana

JUNE 30,	2001 (in thousands)	2000 (in thousands)
ASSETS		
Cash/Cash Equivalents	$ 31,029	$ 29,953
Receivables	24,931	21,617
Due from Other Funds	1,425	491
Inventories	-	27
Investments	455,760	412,432
Securities Lending Collateral	88,689	100,180
Equipment	2,765	2,658
Accumulated Deprec	(1,457)	(1,466)
Intangible Assets	6,016	6,201
Other Assets	686	536
Total Assets	$ 609,844	$ 572,629
LIABILITIES AND FUND EQUITY		
Liabilities:		
Accounts Payable	$ 2,433	$ 1,523
Due to Other Funds	1,105	1,201
Deferred Revenue	16,157	14,593
Lease/Install Purchase Pay	35	42
Property Held in Trust	5,382	999
Securities Lending Liability	88,689	100,180
Compensated Absences Payable	1,161	927
Estimated Insurance Claims	325,900	314,900
Total Liabilities	$ 440,862	$ 434,365
Fund Equity:		
Unrestricted Fund Balance	$ 168,982	$ 138,264
Total Liabilities and Fund Equity	$ 609,844	$ 572,629

The notes to the financial statements are an integral part of this statement.

MONTANA STATE FUND - NEW FUND
STATEMENT OF OPERATIONS AND CHANGE IN FUND EQUITY
The State Fund is a component unit of the State of Montana

YEARS ENDED JUNE 30,	2001 (in thousands)	2000 (in thousands)
Charges for Services	$ 27	$ 21
Investment Earnings	50,971	18,787
Securities Lending Income	5,795	5,371
Contributions/Premiums	74,510	70,657
Payroll Taxes	-	1
Other Operating Revenues	1,466	28
Total Operating Revenues	$ 132,769	$ 94,865
Personal Services	11,084	9,988
Contractual Services	6,389	4,891
Supplies/Materials	1,031	344
Benefits/Claims	73,785	68,434
Depreciation	294	288
Amortization	1,056	987
Utilities/Rent	208	160
Communications	1,062	834
Travel	184	155
Repair/Maintenance	540	502
Securities Lending Expense	5,643	5,207
Dividends	4,995	6,951
Other Operating Expenses	2,484	2,187
Total Operating Expenses	$ 108,755	$ 100,928
Operating Income (Loss)	24,014	(6,063)
Gain/(Loss) Sale of Fixed Assets	(41)	(36)
Transfers In	6,765	-
NET INCOME (Loss)	$ 30,738	$ (6,099)
Prior Period Adjustments	(1,013)	-
Prior Year End Fund Equity	139,257	144,363
END of PERIOD FUND EQUITY	$ 168,982	$ 138,264

The notes to the financial statements are an integral part of this statement.

MONTANA STATE FUND - NEW FUND
STATEMENT OF CASH FLOWS
The State Fund is a component unit of the State of Montana

YEARS ENDED JUNE 30,	2001 (in thousands)	2000 (in thousands)
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts for Premiums	76,697	68,072
Payments to Suppliers for Goods and Services	(12,733)	(6,998)
Payments to Employees	(10,796)	(9,809)
Cash Payments for Claims	(61,436)	(56,640)
Other Operating Receipts	1,491	48
Other Operating Payments	(4,995)	(9,213)
Net Cash Provided by (Used for) Operating Activities	(11,772)	(14,540)
CASH FLOWS FROM NONCAPITAL FINANCIAL ACTIVITIES		
Transfers from Other Funds	6,765	
Transfers to Primary Government	-	(10,000)
Net Cash Provided by (Used for) Noncapital Financing Activities	6,765	(10,000)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of Fixed Assets	(1,337)	(554)
Proceeds from Sale of Fixed Assets	(1)	46
Net Cash Used for Capital and Related Financing Activities	(1,338)	(508)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Investments	(138,855)	(65,585)
Proceeds from Sales or Maturities of Investments	112,748	58,435
Proceeds from Securities Lending Transactions	5,998	5,232
Payments of Security Lending Costs	(5,847)	(5,056)
Interest and Dividends on Investments	33,377	36,078
Net Cash Provided by (Used For) Investing Activities	7,421	29,104
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,076	4,056
CASH AND CASH EQUIVALENTS - JULY 1	29,953	25,897
CASH AND CASH EQUIVALENTS - JUNE 30	31,029	29,953

The notes to the financial statements are an integral part of this statement.

MONTANA STATE FUND - NEW FUND
STATEMENT OF CASH FLOWS
The State Fund is a component unit of the State of Montana

YEARS ENDED JUNE 30,	2001 (in thousands)	2000 (in thousands)
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income (Loss)	24,014	(6,099)
Adjustments to Reconcile Operating Income to Net Cash Porvided by (Used for) Operating Activities		
Depreciation	294	288
Amortization	1,056	987
Security Lending Costs	5,643	5,207
Security Lending Income	(5,795)	(5,371)
Interest on Investment	(50,971)	(18,787)
Decrease (Increase) in		
Accounts Receivable	(3,150)	(39)
Due From Other Funds	(933)	1,306
Inventories	27	6
Other Assets	(150)	224
Increase (Decrease) in		
Accounts Payable	1,108	155
Due to Other Funds	(96)	246
Deferred Revenue	1,564	(4,721)
Property Held in Trust	4,383	575
Estimated Claims	11,000	11,400
Compensated Absences	234	83
Total adjustments	(35,786)	(8,441)
Net Cash Used in Operating Activities	(11,772)	(14,540)

The notes to the financial statements are an integral part of this statement.

MONTANA STATE FUND - OLD FUND
BALANCE SHEET
The State Fund is a component unit of the State of Montana

JUNE 30,	2001 (in thousands)	2000 (in thousands)
ASSETS		
Cash/Cash Equivalents	$ 10,465	$ 8,980
Receivables	2,198	2,369
Due from Other Funds	1	11
Investments	116,383	126,378
Securities Lending Collateral	5,080	5,317
Other Assets	-	17
Total Assets	$ 134,127	$ 143,072
LIABILITIES AND FUND EQUITY		
Liabilities:		
Accounts Payable	$ 50	$ 30
Due to Other Funds	846	501
Deferred Revenue	606	656
Securities Lending Liability	5,080	5,317
Compensated Absences Payable	63	63
Estimated Insurance Claims	104,700	117,945
Total Liabilities	$ 111,345	$ 124,512
Fund Equity:		
Contributed Capital	$ 154,468	$ 154,468
Unrestricted Fund Balance	(131,686)	(135,908)
Total Fund Equity	$ 22,782	$ 18,560
Total Liabilities and Fund Equity	$ 134,127	$ 143,072

The notes to the financial statements are an integral part of this statement.

MONTANA STATE FUND - OLD FUND
STATEMENT OF OPERATIONS AND CHANGE IN FUND EQUITY
The State Fund is a component unit of the State of Montana

YEARS ENDED JUNE 30,	2001 (in thousands)	2000 (in thousands)
Investment Earnings	$ 13,038	$ 5,132
Securities Lending Income	394	410
Payroll Taxes	113	1,892
Total Operating Revenues	$ 13,545	$ 7,434
Contractual Services	$ 1,123	$ 1,146
Benefits/Claims	691	1,302
Securities Lending Expense	385	396
Other Operating Expenses	359	407
Total Operating Expenses	$ 2,558	$ 3,251
Operating Income (Loss)	$ 10,987	$ 4,183
Transfer Out	(6,765)	-
NET INCOME (Loss)	$ 4,222	$ 4,183
Prior Year End Fund Equity	18,560	14,377
END of PERIOD FUND EQUITY	$ 22,782	$ 18,560

The notes to the financial statements are an integral part of this statement.

MONTANA STATE FUND - OLD FUND
STATEMENT OF CASH FLOWS
The State Fund is a component unit of the State of Montana

YEARS ENDED JUNE 30,	2001 (in thousands)	2000 (in thousands)
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments to Suppliers for Goods and Services	(1,138)	(1,362)
Cash Payments for Claims	(13,918)	(13,421)
Collection of Payroll Taxes	121	
Other Operating Receipts	-	3,028
Net Cash Provided by (Used for) Operating Activities	(14,935)	(11,755)
CASH FLOWS FROM NONCAPITAL FINANCIAL ACTIVITIES		
Transfers to Other Funds	(6,765)	-
Net Cash Provided by (Used for) Noncapital Financing Activities	(6,765)	-
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Investments	(29,139)	(13,332)
Proceeds from Sales or Maturities of Investments	44,054	16,762
Proceeds from Securities Lending Transactions	393	410
Payments of Security Lending Costs	(402)	(396)
Interest and Dividends on Investments	8,279	8,621
Net Cash Provided by (Used For) Investing Activities	23,185	12,065
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,485	310
CASH AND CASH EQUIVALENTS - JULY 1	8,980	8,670
CASH AND CASH EQUIVALENTS - JUNE 30	10,465	8,980

The notes to the financial statements are an integral part of this statement.

MONTANA STATE FUND - OLD FUND
STATEMENT OF CASH FLOWS
The State Fund is a component unit of the State of Montana

YEARS ENDED JUNE 30,	2001 (in thousands)	2000 (in thousands)
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income (Loss)	10,987	4,183
Adjustments to Reconcile Operating Income to Net Cash Provided by (Used for) Operating Activities		
Security Lending Costs	385	396
Security Lending Income	(394)	(410)
Interest on Investment	(13,036)	(5,132)
Decrease (Increase) in		
Accounts Receivable	10	386
Due From Other Funds	10	419
Other Assets	16	108
Increase (Decrease) in		
Accounts Payable	38	-
Due to Other Funds	345	212
Deferred Revenue	(51)	222
Estimated Claims	(13,245)	(12,119)
Other Liabilities	-	(20)
Total adjustments	(25,922)	(15,938)
Net Cash Used in Operating Activities	(14,935)	(11,755)

The notes to the financial statements are an integral part of this statement.

1. Summary of Significant Accounting Policies

Description of Business

The Montana State Fund (State Fund) is a nonprofit, independent public corporation established under Title 39, Chapter 71 of the Montana Code Annotated (MCA). The State Fund provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. The State Fund is governed by a seven member Board of Directors appointed by the Governor. The State Fund is attached to the State of Montana, Department of Administration for administrative purposes only.

During the 1990 Montana Special Legislative Session, legislation passed establishing separate funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990, referred to as the Old Fund, and claims occurring on or after July 1, 1990, referred to as the New Fund.

The New Fund functions as an autonomous insurance entity supported solely from its own revenues. All assets, debts, and obligations of the New Fund are separate and distinct from assets, debts, and obligations of the State of Montana. Upon dissolution of the New Fund, any monies not needed to liquidate the New Fund would be subject to legislative provision according to state law (Section 39-71-2322, MCA). The State Fund administers and manages the claims remaining in the Old Fund for the State of Montana and is the administering entity for recording the financial activity related to receipt and disbursement of an Old Fund Liability Tax (see Note 4). No State general fund money is used for State Fund operations.

Because of the Governor's appointment of the board members and the state's regulatory oversight function, the State Fund financial statements are presented as a component unit in the State of Montana Comprehensive Annual Financial Report.

The fiscal year 2001 financial statements are presented in a comparable format as the State of Montana Comprehensive Annual Financial Report. This presentation is different than that of fiscal year 2000. Fiscal year 2000 information has been reformatted to be consistent with the Comprehensive Annual Financial Report.

Basis of Accounting

The State Fund uses the accrual basis of accounting, as defined by generally accepted accounting principles, for its workers' compensation insurance operations. Under the accrual basis, the State Fund records revenues in the accounting period earned, if measurable, and records expenses in the period incurred, if measurable.

(All dollar values are expressed in 000's.)

Cash and Cash Equivalents

Cash balances include demand deposits with the State Treasury. The State Fund also participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less. There are no legal risks that the Montana Board of Investments (BOI) is aware of regarding any STIP investments. The market value of STIP approximates cost. The New Fund STIP balance of $28,618 as of June 30, 2001 represented 1.70% of the total STIP. The Old Fund STIP balance of $10,243 as of June 30, 2001 represented 0.61% of the total STIP. The New Fund STIP balance of $27,517 as of June 30, 2000 represented 2.04% of the total STIP. The Old Fund STIP balance of $5,733 as of June 30, 2000 represented 0.42% of the total STIP.

The STIP investments' credit risk is measured by investment grade ratings given individual securities. The BOI's policy requires that STIP investments have the highest rating in the short-term category by one and/or any Nationally Recognized Statistical Rating Organizations (NRSRO). The four NRSRO's include Standard and Poor's, Moody's Investors Service, Fitch IBCA Duff and Phelps, and Thomson Bank Watch.

Asset-backed securities constituted 39.79% of the BOI's total STIP portfolio as of June 30, 2001. Asset-backed securities have less credit risk than do securities not backed by pledged assets. Market risk for asset-backed securities is the same as market risk for similar non asset-backed securities. Asset-backed securities constituted 28.86% of the Board of Investment's total STIP portfolio as of June 30, 2000.

Variable rate (floating rate) securities made up 17.98% of the BOI's total STIP portfolio as of June 30, 2001. Variable rate securities made up 4.68% of the BOI's total STIP portfolio as of June 30, 2000. While variable rate securities have credit risk identical to similar fixed rate securities, their market risk (income) is more sensitive to interest rate changes. However, the market risk (value/price) may be less volatile than fixed rate securities because their value will usually remain at or near par as a result of their interest rates being periodically reset to maintain a current market yield.

Investments

In addition to STIP investments, the State Fund invests in long-term securities with the BOI. Securities are stated at fair value as defined and required by Governmental Accounting Standards Board (GASB) Statement Number 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools". Premiums and discounts are amortized using the straight-line method over the life of the securities. Net unrealized gains or losses on securities are included in net

income in accordance with GASB 31.

State Fund investments are classified in risk Category 1 or as Not Categorized under State of Montana standards. Risk category 1 includes investments that are insured or registered and held by the BOI or its agent in the BOI's name. Not Categorized includes investments held by broker-dealers under loans with cash collateral. Asset-backed securities have less credit risk than do securities not backed by pledged assets. Market risk for asset-backed securities is the same as market risk for similar non asset-backed securities.

Under the provisions of state statutes, the BOI has, by a Securities Lending Authorization Agreement, authorized the custodial bank to lend the BOI's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. State Street Bank was appointed the BOI's custodial bank on December 1, 1993. During the period the securities are on loan, the BOI receives a fee and the bank must initially receive collateral equal to 102% of the market value of the securities on loan and must maintain collateral equal to not less than one hundred percent of the market value of the loaned security. The BOI retains all rights and risks of ownership during the loan period.

During fiscal years ended June 30, 2001 and June 30, 2000, State Street loaned, on behalf of the BOI, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. Government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The BOI did not impose any restrictions during fiscal years 2001 and 2000 on the amount of the loans that State Street made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during fiscal years 2001 and 2000. There were no losses during fiscal years 2001 and 2000 resulting from default of the borrowers or State Street.

During fiscal years ended June 30, 2001 and June 30, 2000, the BOI and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality trust. The relationship between the average maturities of the investment pool and the BOI's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the BOI could not determine. On June 30, 2001 and June 30, 2000, the BOI had no credit risk exposure to borrowers.

The following table presents the carrying and market values of the securities on loan and the total collateral held for fiscal years ended June 30, 2001 and June 30,2000 for both the New Fund and the Old Fund:

(All dollar values are expressed in 000's.)

	NEW FUND Fiscal Year 2001	FUND Fiscal Year 2000	OLD FUND Fiscal Year 2001	FUND Fiscal Year 2000
Securities on Loan-Book Value	$80,459	$94,982	$4,743	$5,220
Securities on Loan-Market Value	$85,194	$96,498	$4,871	$5,182
Total Collateral Held	$88,689	$100,180	$5,080	$5,317

As of June 30, 2001, investments in the New Fund and the Old Fund include $80,459 (approximately 18.8 % of total long-term securities), and $4,743 (approximately 1.1% of total long-term securities), respectively, in long-term securities on loan that earned interest income during the fiscal year of $5,795 and $394 respectively.

As of June 30, 2000, investments in the New Fund and the Old Fund include $94,982 (approximately 22.5% of total long-term securities), and $5,220 (approximately 4.1% of total long-term securities), respectively, in long-term securities on loan that earned interest income during the fiscal year of $5,371 and $410 respectively.

During fiscal year 2001, the BOI decreased the book value of one long-term bond by the amounts of $420 for New Fund and $387 for Old Fund. The write-downs were recorded against investment income.

In November 2000, the Montana Constitution was amended to allow investing in equity securities, with the restriction that equity securities cannot exceed 25% of total investment book value. The BOI began purchasing equity securities January 1, 2001 and plans to purchase $4,000 per month for eighteen months, but not to exceed 16% of New Fund's total investment book value. As of June 30, 2001, equity securities in the New Fund include $24,000 at book value, offset by $296 in market value depreciation.

Receivables

The New Fund premium receivable balance of $18,009 at June 30, 2001 includes $4,024 of premium due from insureds for insurance coverage provided during fiscal year 2001 not yet received. The remaining $13,985 represents advance premiums billed but not received for insurance coverage effective July 1, 2001 as part of the State Fund's Premium in Advance program. This amount is offset in deferred revenue. Estimated uncollectible receivables are reported as an allowance for doubtful accounts of $394. Other receivables include $7,164 in investment income due, and $1,425 due from other state agencies and funds.

(All dollar values are expressed in 000's.)

The New Fund premium receivable balance of $14,948 at June 30, 2000 includes $4,600 of premium due from insureds for insurance coverage provided during fiscal year 2000 not yet received. The remaining $10,348 represents advance premiums billed but not received for insurance coverage effective July 1, 2000 as part of the State Fund's Premium in Advance program. This amount is offset in deferred revenue. Estimated uncollectible receivables are reported as an allowance for doubtful accounts of $394. Other receivables include $6,989 in investment income due, and $491 due from other state agencies and funds.

Accounts receivable in the Old Fund includes amounts due from past premiums in dispute or in collection and amounts due from Old Fund Liability Tax collections. Interest receivable of $1,425 at June 30, 2001 and $1,586 at June 30, 2000 represents investment income due. Estimated uncollectible receivables are reported as an allowance for doubtful accounts.

Equipment and Accumulated Depreciation

Equipment is capitalized if the actual or estimated historical cost exceeds $5. Depreciation expense is computed on a straight-line basis for equipment over a period of five to ten years. Amortization of intangible assets is computed on a straight-line basis over a period of three to seven years and is applied directly to the asset balance. All fixed assets are recorded in the New Fund. Because the State Fund administers the Old Fund, the Old Fund does not carry fixed assets.

Other Assets

Other assets include security deposits from certain policyholders that secure payment of premiums. Also included are deferred acquisition costs incurred during the policy writing process and that are recognized ratably over the related policy term.

Deferred Revenue

Deferred revenue reflects amounts in advance that are received or billed, but not yet earned for policies effective July 1, 2001 or July 1, 2000.

Fund Equity

Fund Equity consists of the net excess or deficit of assets over liabilities.

Contributions and Premiums

The State Fund Board of Directors approves premium rates annually. Policies are effective for the term of the policy period not to exceed 12 months. Revenue from premiums is recognized over the

term of the fiscal year, which runs from July 1 through June 30.

Policyholders are contractually obligated to pay certain premiums to the State Fund in advance of the period the premiums are earned. Premium advances are refundable when the policyholder's coverage is canceled and all earned premiums have been credited by the State Fund.

Presentation

The financial statements are presented in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. State Fund insurance operations are classified as an Enterprise Fund, Proprietary Fund type.

The Enterprise Fund of the State Fund is part of, but does not comprise, the entire Enterprise Fund of the State of Montana. The financial statements in this report reflect the financial position and results of operations and cash flows of the Montana State Fund (New Fund and Old Fund), not the State of Montana.

The Enterprise Fund is used to account for operations: (a) financed and operated in a manner similar to private business enterprises, where the legislature intends that the entity finance or recover costs primarily through user charges; or (b) where the legislature has decided that periodic determination of revenues earned, expenses incurred, or net income is appropriate.

According to GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and External Investment Pools, STIP is considered an external investment pool. An external investment pool is defined as an arrangement that pools the monies of more than one legally separate entity and invests, on the participant's behalf, in an investment portfolio. STIP is also classified as a "2a7-like" pool. A 2a7-like pool is an external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. If certain conditions are met, 2a7-like pools are allowed to use amortized cost rather than fair value to report net assets to compute unit values. The Board of Investments has adopted a policy to treat STIP as a 2a7-like pool.

See Note 2 for further discussion of the effect of GASB 31.

(All dollar values are expressed in 000's.)

2. Investments

The amortized cost and market value of the New Fund fixed maturity securities as of June 30, 2001, and June 30, 2000, are as follows:

		Gross Unrealized		
June 30, 2001	Amortized Cost	Gains	Loss	Market Value
Government Direct-Indirect	$ 144,862	$ 6,770	$ 795	$ 150,837
Government Mortgage-Backed	46,787	295	604	46,478
Corporate Securities Asset-Backed	20,223	324	-	20,547
Other Corporate Securities	204,339	5,191	1,924	207,606
Other Securities	6,970	48	430	6,588
Equity Securities	24,000	-	296	23,704
STIP (reported as Cash & Cash Equivalents)	28,618	-	-	28,618
Total	$ 475,799	$ 12,628	$ 4,049	$ 484,378

		Gross Unrealized		
June 30, 2000	Amortized Cost	Gains	Loss	Market Value
U.S. Treasury Securities	$ 84,161	$ 2,000	$ 273	$ 85,888
U.S. Government Agencies and U.S. Government Guaranteed Securities	83,066	648	3,309	80,405
Corporate Securities Asset Backed	41,385	-	333	41,052
Other Corporate Securities	193,747	691	7,615	186,823
Other Securities	18,945	-	681	18,264
STIP (reported as Cash & Cash Equivalents)	27,517	-	-	27,517
Total	$448,821	$ 3,339	$12,211	$439,949

The amortized cost and estimated market value of the New Fund's fixed maturity securities as of June 30, 2001 and June 30, 2000, are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(All dollar values are expressed in 000's.)

June 30, 2001

	Amortized Cost	Market Value
Due one year or less	$ 33,656	$ 33,068
Due after one year through five years	165,505	170,332
Due after five years through ten years	125,897	129,727
Due after ten years	126,741	127,547
Equity Securities	24,000	23,704
Totals	$ 475,799	$ 484,378

June 30, 2000

	Amortized Cost	Market Value
Due one year or less	$ 39,179	$ 39,046
Due after one year through five years	241,528	237,383
Due after five years through ten years	111,800	109,761
Due after ten years	56,314	53,760
Totals	$ 448,821	$ 439,950

During fiscal year ending June 30, 2001, the New Fund realized gross gains from sales of securities of $2,583 and gross realized losses of $460. During fiscal year ending June 30, 2000, the New Fund realized gross gains from sales of securities of $640 and gross realized losses of $300.

As discussed in Note 1, GASB 31 requires governmental entities to state their investments at fair value. Fair value is defined as the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The adjustment to fair value is reflected as an increase or decrease in investment income. During fiscal year 2001, investment income for the New Fund was adjusted upward $17,449 due to the unrealized gain on long-term investments. Investment income for fiscal year 2000 was adjusted downward $11,458 for the unrealized loss that occurred during that year on long-term investments.

The amortized cost and market value of the Old Fund fixed maturity securities as of June 30, 2001and June 30, 2000 are as follows:

(All dollar values are expressed in 000's.)

June 30, 2001	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Market Value
Government Direct-Indirect	$ 41,251	$ 331	$ 804	$ 40,778
Government Mortgage-Backed	15,784	-	229	15,555
Corporate Securities Asset-Backed	19,386	236	-	19,622
Other Corporate Securities	35,591	450	269	35,772
Other Securities	5,009	32	384	4,657
STIP (reported as Cash & Cash Equivalents)	10,243	-	-	10,243
Total	$ 127,264	$ 1,049	$ 1,686	$ 126,627

June 30, 2000	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Market Value
U.S. Treasury Securities	$ 5,049	$ -	$ 33	$ 5,016
U.S. Government Agencies and U.S. Government Guaranteed Securities	30,272	-	1,203	29,069
Government Mortgage-Backed	18,443	-	955	17,488
Corporate Securities Asset-Backed	30,010	4	416	29,598
Other Corporate Securities	41,140	13	2,589	38,564
Other Securities	7,013	-	370	6,643
STIP (reported as Cash & Cash Equivalents)	5,733	-	-	5,733
Total	$ 137,660	$ 17	$ 5,566	$ 132,111

The amortized cost and market value of the Old Fund fixed maturity securities as of June 30, 2001 and June 30, 2000 are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

June 30, 2001	**Amortized Cost**	**Market Value**
Due one year or less	$ 10,243	$ 10,243
Due after one year through five years	51,131	51,394
Due after five years through ten years	26,534	26,656
Due after ten years	39,356	38,334
Totals	$ 127,264	$ 126,627

(All dollar values are expressed in 000's.)

June 30, 2000

	Amortized Cost	Market Value
Due one year or less	$ 7,387	$ 7,374
Due after one year through five years	82,251	79,121
Due after five years through ten years	29,466	28,188
Due after ten years	18,556	17,428
Totals	$ 137,660	$ 132,111

During fiscal year 2001, investment income for the Old Fund was increased $ 4,912 due to the unrealized gain on its long-term portfolio. During fiscal year 2000, the effect of GASB 31 on Old Fund investment income was a decrease of $ 3,321.

During the fiscal year ended June 30, 2001, the Old Fund realized $386 in gross gains from sales of securities and gross realized losses of $394. During the fiscal year ended June 30, 2000, the Old Fund realized $17 in gross gains from sales of securities and $109 in gross realized losses.

3. Reinsurance

For the fiscal years ended June 30, 2001 and June 30, 2000 the State Fund ceded reinsurance to other insurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against losses over stipulated amounts and an aggregate stop loss contract covering fiscal year 2001. The aggregate stop loss contract covering fiscal year 2000 was commuted. During fiscal year 2001 the State Fund retained the first $3,000 with a $500 aggregate annual deductible for the first layer of reinsurance coverage. During fiscal year 2000 the State Fund retained the first $1,500 with a $750 in aggregate annual deductible for the first layer. Individual, per person coverage was provided up to $5 million per claimant and is subject to an annual limit of $10 million. In the event reinsurers are unable to meet their obligations, the State Fund would remain liable for all losses, as the reinsurance agreements do not discharge the State Fund from its primary liability to the policyholders.

The State Fund purchased reinsurance coverage for employers' liability insurance offered to policyholders during fiscal years 2001 and 2000. The State Fund retains the first $200 in ultimate net loss for any one occurrence while reinsurers are liable for losses in excess of $200 up to a limit of $1 million.

Premium revenue is reduced by premiums paid for reinsurance coverage of $2,952 and $855 in

fiscal years 2001 and 2000 respectively.

During fiscal years 2001 and 2000, estimated claim reserves were reduced $4,000 and $7,000 respectively, for the amount of reinsurance estimated to be ultimately recoverable on incurred losses.

The State Fund also has an assumed reinsurance relationship with Legion Insurance Company related to Other States Coverage (OSC). The State Fund assumes risk for OSC claims, which are then covered under the State Fund's ceded reinsurance contract. Assumed premium for fiscal years 2001 and 2000 are $671 and $58, respectively.

4. Risk Management/Public Entity Risk Pool

The Old and New Funds are public entity risk pools. Neither fund had significant reductions in insurance coverage from the prior year, nor any insurance settlements exceeding insurance coverage. Unpaid claims and claims adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other socioeconomic factors.

The New Fund provides liability coverage to employers for injured employees that are insured under the Workers' Compensation and Occupational Disease Acts of Montana. Workers' compensation claims occurring on or after July 1, 1990, are reported in the New Fund. The New Fund must insure any employer who desires coverage. At June 30, 2001, approximately 23,915 employers were insured by the New Fund. At June 30, 2000, approximately 23,481 employers were insured by the New Fund. Anticipated investment income is considered when computing premium rate levels and employers must pay premiums to the State Fund within specified time frames.

Tillinghast-Towers Perrin prepared an actuarial study used to estimate liabilities and the ultimate cost of settling claims reported but not settled and claims incurred but not reported for the New Fund as of June 30, 2001 and June 30, 2000. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors.

A provision for inflation and the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. As of June 30, 2001, $325,900 of unpaid claims and claim adjustment expenses are presented at face value net of estimated reinsurance recoverable. As of June 30, 2000, $314,900 of unpaid claims and

(All dollar values are expressed in 000's.)

claim adjustment expenses are presented at face value. When the New Fund purchases annuity contracts, the claim is settled in full and on a final basis, and all liability of the New Fund is terminated.

State law requires the New Fund to set premiums at least annually at a level sufficient to ensure adequate funding of the insurance program during the period the rates will be in effect. State law also requires the State Fund to establish a minimum surplus balance of 25% of annual premium revenue.

Acquisition costs represent costs associated with the acquisition of new insurance contracts or renewal of existing contracts and include agent commissions and expenses incurred in the underwriting process. New Fund acquisition costs are capitalized and amortized ratably over the subsequent year. The amount of capitalized acquisition costs at June 30, 2001 and June 30, 2000 is $389 and $171 respectively. For the year ended June 30, 2001, $171 of acquisition costs were amortized. There were no acquisition costs amortized for the year ended June 30, 2000.

The Old Fund covers the liability and payment of workers' compensation claims for incidents occurring before July 1, 1990. Funding for claims payments was provided by Old Fund Liability Taxes (OFLT) imposed on employer payroll (0.5%), employee wages (0.2%), and sole proprietor and subchapter S shareholder distributive income (0.2%). The OFLT is no longer in effect, however, revenue on past taxes is still being received and totaled $113 and $1,892 for June 30, 2001 and June 30, 2000, respectively.

An actuarial study prepared by Tillinghast-Towers Perrin for the Old Fund as of June 30, 2001 and June 30, 2000, was used to estimate liabilities and the ultimate cost of settling claims that have been reported, but not settled and claims that have been incurred, but not reported. As of June 30, 2001, $148,476 of unpaid claims and unpaid claim adjustment expenses are presented at their net present value of $104,700 discounted at a 5.5% rate. As of June 30, 2000, $167,915 of unpaid claims and unpaid claim adjustment expenses are presented at their net present value of $117,945. Total Old Fund surplus as of June 30, 2001 is $22,782 compared to $18,560 as of June 30, 2000.

Changes in Claims Liabilities for the Past Two Years

The following table presents changes in the aggregate liabilities for the New Fund and the Old Fund for the past two years net of estimated reinsurance recoverable. The information presented has not been discounted.

(All dollar values are expressed in 000's.)

	New Fund		Old Fund	
	2001	2000	2001	2000
Unpaid claims and claim adjustment expenses at beginning of year	$314,900	$303,500	$167,915	$185,064
Incurred claims and claim adjustment expenses:				
Provision for insured events of the current year	75,465	74,445		
Increase (decrease) in provision for events of prior years	(1,667)	(6,049)	(5,503)	(3,728)
Total incurred claims and claim adjustment expenses	73,798	68,396	(5,503)	(3,728)
Payments:				
Claims and claim adjustment expenses attributable to insured events of the current year	(14,140)	(13,177)		
Claims and claim adjustment expenses attributable to insured events of prior years	(48,658)	(43,819)	(13,936)	(13,421)
Total Payment	(62,798)	(56,996)	(13,936)	(13,421)
Total unpaid claims and claim adjustment expenses at end of year	$325,900	$314,900	$148,476	$167,915

Risk Management Trend Information

The following table illustrates how the earned revenues of the New Fund plus investment income compare to related costs of loss and other expenses assumed by the State Fund for fiscal years 1992 through 2001. In addition, cumulative amounts related to estimated and actual paid claims are presented. The information allows for comparison of actual and estimated claims and is a basis for developing revenue and claims information. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is used to evaluate the accuracy of incurred claims currently recognized for less mature policy years.

(All dollar values are expressed in 000's.)

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2001 and 2000

New Fund

		1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
1	Premiums and Investment Revenue										
	Earned	$162,216	$213,418	$230,333	$189,294	$133,469	$101,144	$85,954	$76,683	$84,569	$97,539
	Ceded	270	289	318	269	519	348	303	260	855	2,952
	Net Earned	$161,946	$213,128	$230,014	$189,025	$132,949	$100,796	$85,651	$76,422	$83,714	$94,587
2	Unallocated expenses including overhead	6,588	7,889	9,060	15,131	18,192	13,413	15,199	20,081	23,892	29,527
3.	Estimated losses and expenses, end of accident year										
	Incurred	$183,425	$186,480	$199,890	$164,628	$95,067	$76,067	$64,983	$64,645	$65,957	$68,267
	Ceded	0	0	0	0	0	0	0	838	0	0
	Net Incurred	$183,425	$186,480	$199,890	$164,628	$95,067	$76,067	$64,983	$63,807	$65,957	$68,267
4	Net paid (cumulative) as of:										
	End of policy year	$20,244	$18,347	$18,693	$18,137	$15,818	$12,589	$12,943	$13,723	$13,177	$14,140
	One year later	50,576	46,343	45,947	40,473	32,890	28,451	28,222	29,976	29,218	
	Two years later	68,837	62,717	60,971	52,073	42,361	35,706	35,753	39,298		
	Three years later	77,950	71,666	67,576	58,722	47,283	39,860	41,004			
	Four years later	83,173	76,280	72,212	62,419	50,267	43,105				
	Five years later	86,461	80,165	75,799	65,919	52,791					
	Six years later	89,370	82,981	78,306	68,541						
	Seven years later	91,903	85,357	80,861							
	Eight years later	94,131	88,080								
	Nine years later	96,690									
5.	Re-estimated ceded losses and expenses	0	0	0	0	1,328	0	1,556	1,116	0	0
6.	Re-estimated net incurred losses and expenses:										
	End of policy year	$183,425	$186,480	$199,890	$164,628	$95,067	$76,067	$64,983	$63,807	$65,957	$68,267
	One year later	184,968	184,030	184,920	124,123	88,923	67,235	64,308	64,348	66,421	
	Two years later	175,218	167,052	135,472	107,074	77,286	59,054	60,467	66,660		
	Three years later	161,184	133,017	116,756	95,456	73,864	60,811	61,989			
	Four years later	135,775	120,583	107,656	94,517	74,022	64,439				
	Five years later	125,084	111,208	105,052	92,231	73,197					
	Six years later	119,780	109,415	106,039	91,771						
	Seven years later	120,472	111,638	105,668							
	Eight years Later	120,397	111,084								
	Nine years later	119,265									
7.	Increase (decrease) in estimated net incurred losses and expenses from end of policy year	(64,160)	(75,396)	(94,222)	(72,857)	(21,870)	(11,628)	(2,994)	2,853	464	0

(All dollar values are expressed in 000's.)

5. Administrative Cost Allocation

State law (Section 39-71-2352, MCA) requires the State Fund to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (New Fund). The law also limits annual administrative costs of claims associated with the Old Fund to $1,250 for both fiscal years 2001 and 2000. The State Fund allocated $1,250 in administration costs to the Old Fund in fiscal years 2001 and 2000. The Old Fund has a $772 obligation to the New Fund in unrecovered administrative costs incurred in fiscal years 2001 and prior. The New Fund intends to recover this amount in future years where the cost of administering the Old Fund is less than the statutorily permitted $1,250.

6. New Fund Surplus Distributions

Dividend Paid to Policyholders

During the fiscal years ended June 30, 2001 and June 30, 2000, the State Fund Board of Directors authorized and paid dividends to policyholders for $4,995 and $6,951, respectively.

Transfer from Old Fund to New Fund

Section 39-71-2352 (5), MCA provides for the payment of excess funds from the Old Fund to the New Fund based on adequate funding levels in the Old Fund (see Note 7). The transfer amount in fiscal year 2001 is $6,765 and there was no transfer in fiscal year 2000.

7. Old Fund Surplus Position

The State's Budget Director determined, based on the recommendation presented by the State Fund Board of Directors in September 1998, that the Old Fund Liability Tax could end on January 1, 1999 in compliance with state law.

Because the Old Fund was determined to be adequately funded as of December 31, 1998, the Old Fund Liability Tax was terminated and a process was put in place to measure the status of the Old Fund's surplus level annually on a present value basis using a discount factor of 5.5% to determine compliance with state law requirements for maintaining fund adequacy.

State law defines the term "adequately funded" to mean the present value of:

a) the total cost of future benefits remaining to be paid; and,
b) the cost of administering the claims; and,
c) an amount equal to 10% of the total of the amounts in subsections (a) and (b) above.

(All dollar values are expressed in 000's.)

As of June 30, 2001 the Old Fund surplus level using a present value discount factor of 5.5% was $22,782. The 10% contingency required to be retained in excess of the full cost needed to cover the expense of the administration and payment of any unpaid claims equaled $10,470.

As of June 30, 2000 the Old Fund surplus level using a present value discount factor of 5.5% was $18,573. The 10% contingency required to be retained in excess of the full cost needed to cover the expense of the administration and payment of any unpaid claims equaled $11,795.

8. Compensated Absences

Employees at the State Fund accumulate both annual leave and sick leave. The State Fund pays employees for 100% of unused annual leave and 25% of unused sick leave upon termination. The fund pays 100% of unused compensatory leave credits upon termination to nonexempt employees. The State Fund absorbs expenditures for termination pay in its annual operational costs. The State Fund had a total leave liability of $1,225 and $990 at June 30, 2001 and 2000, respectively.

9. Pension Plan

The State Fund and its employees contribute to the Public Employees Retirement System (PERS), a mandatory multiple-employer, cost-sharing, defined benefit pension plan administered by the State of Montana Public Employees Retirement Administration (PERA). The PERS offers retirement, disability and death benefits to plan members and their beneficiaries. Established in 1945, the plan is governed by Title 19, Chapters 2 and 3, MCA. PERS participants are eligible to retire at age 60 with at least five years of service, at age 65 regardless of length of service or at 30 years of service regardless of age. Actuarially reduced retirement benefits may be taken with 25 years of service or at age 50 with a minimum of five years of service. Monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals 5 years. The authority to establish and amend contribution rates and to provide cost of living adjustments for the plan is assigned to the State legislature. State Fund and its employees each were required to contribute 6.9% of annual compensation in fiscal years 2001 and 2000 The State Fund's contributions amounted to $583 for fiscal year 2001 and $547 for fiscal year 2000. State Fund and its employees paid one hundred percent of required contributions to PERS and there is no unpaid liability as of June 30, 2001.

The PERS financial information is reported in the Public Employees' Retirement Board *Comprehensive Annual Financial Report* for the fiscal year-end. It is available from the PERA at 100 North Park Avenue, Suite 220, P. O. Box 200131, Helena, MT 59620-0131, (406) 444-3154.

(All dollar values are expressed in 000's.)

10. Building

The 1981 Legislature appropriated funds for the construction of a Workers' Compensation building. As of July 1, 1990, the State Fund transferred the value of the building from its records to the Department of Administration, which owns most other state buildings and charges agencies rent for their use. Under an agreement, the State Fund pays all costs associated with the building, including utilities, property taxes, janitorial services, and maintenance in lieu of paying rent.

11. Contingencies

Broeker v. State Fund. The issue in this case involved the way insurers calculated the social security disability offset rates on certain claims.

The Workers' Compensation Court decision stated that where there is a cost of living increase built into the initial entitlement to social security disability benefits the workers' compensation insurer cannot take the cost of living increase into consideration when computing the SSDI offset rate. There is a cost of living offset built into the initial social security entitlement in those claims where the injured worker did not apply for social security disability close to the date of injury.

On appeal, the Montana Supreme Court affirmed the Workers' Compensation Court decision. This decision appears to affect those similarly situated claimants. The case was settled. The settlement provides for review of certain claims and the Montana State Fund is proceeding in accordance with the terms of the settlement.

Murer, et al. v. Montana State Compensation Mutual Insurance Fund, et al. WCC No. 9206-6487, involves the 1987 legislature's capping of workers' compensation benefits ($ .299 a week for total benefits and $ .149 a week for partial benefits) for injuries occurring during the period July 1, 1987 through June 30, 1989. The 1989 legislature reenacted those caps for the period July 1, 1989 through June 30, 1991 for injuries occurring between July 1, 1989 and June 30, 1991.

The Montana Supreme Court found that these caps should have expired on June 30, 1989 for injuries occurring between July 1, 1987 and June 30, 1989 and should have expired on June 30, 1991 for injuries occurring between July 1, 1989 and June 30, 1991.

As a result, the Montana State Fund, under Workers' Compensation Court direction, performed a review of approximately 7,500 claims occurred. Those claims qualifying are paid 85% of the increased rate, with 15% paid to the claimant attorney. Cost impact estimated to be over $1,000 but with a cost no greater than $2,000. The review and payment process is near to finalization.

State Compensation Insurance Fund v. George Berg, et al. Case No. DV-99-34 (Fergus County), is a pending suit against a former policyholder in which the Montana State Fund claims the policyholder failed

to pay workers' compensation insurance premiums, plus interest on the unpaid premiums. The total claim was originally for $1,046, but on further evaluation has been reduced to approximately $660. Berg filed a counterclaim against the Montana State Fund on various claims, seeking unspecified damages. The State Fund does not think the counterclaim has merit, but there is a remote chance of an adverse judgment against the Montana State Fund. This matter was expected to go to trial sometime during 2001. However, Berg filed a Chapter 11 bankruptcy petition in Montana Bankruptcy Court, which stayed any further proceedings in the state court action. The Montana State Fund entered into a tentative settlement with Berg for payment of $100 cash, plus $125 payable over time. This settlement was subject to approval by the bankruptcy court in a Chapter 11 plan of reorganization. However, the bankruptcy court converted the case to Chapter 7 liquidation. This had the effect of resurrecting the Montana State Fund's original claim amount of $660. At this time, the State Fund is not certain how much of this claim will be recovered.

Michael Powell vs. State Fund. In this case the issue involves the constitutionality of Section 39-71-1011(4), MCA, which places a cap on compensation paid to family members who provide domiciliary care. The claimant asserts that his rights to equal protection and privacy are violated by the statute. The State Fund prevailed in the Workers' Compensation Court with a finding that the statute did not violate claimant's rights. The issue was appealed to the Supreme Court, and on December 21, 2000 the Supreme Court affirmed the Workers' Compensation Court's decision.

Stavenjord v. State Compensation Insurance Fund. The Stavenjord case was issued by the Workers' Compensation Court on May 22, 2001. It addressed the issue of whether the failure of the Occupational Disease Act (ODA) to provide PPD (permanent partial disability) benefits equivalent to the benefits provided in the Montana WCA (workers' compensation act) violates the claimant's right to equal protection of the law. Relying on the Henry case (previous case from the Supreme Court finding that vocational rehabilitation benefits must also be paid under the ODA), the court said it did, saying "Where PPD benefits calculated pursuant to the WCA are greater that the benefits available to a claimant under the ODA, constitutional equal protection guarantees require that benefits be computed and paid in accordance with the WCA. The claimant in this case is entitled to $27 under the WCA, versus $10 under the ODA." Preliminary estimates indicate that the Stavenjord decision will increase claim costs by nearly $1,000 a year for the State Fund. The case is currently on appeal by the State Fund to the Montana Supreme Court.

MONTANA STATE FUND

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Carl W. Swanson, President/CEO

November 27, 2001

Mr. Scott A. Seacat
Legislative Audit Division
Room 160, State Capitol
Helena, MT 59620-1705

Dear Mr. Seacat:

Montana State Fund (MSF) thanks the Legislative Audit Division for their review of our financial statements for the fiscal year ended June 30, 2001, with comparison to the prior fiscal year. We also want to thank the audit staff involved for their professionalism and assistance in completion of the audit.

We are especially pleased with your issuance of an unqualified opinion without any recommendations on the financial statements we have presented. As shown in the statements, the MSF issued a $5 million dividend to the employers of the State. Added with the previous two years, a total of $22 million has been returned to our customers. In November of 2000, MSF implemented a significantly revised organizational structure designed to meet the needs and expectations of our customers. As a result, the traditional layers of separate functional departments were replaced with six multi-functional teams focused on providing exemplary customer service to their specific group of customers and employees. Consequently, customer relationships have improved and MSF employees have the decision-making authority to be more responsive to their customer's needs.

The management and staff of MSF are very proud of our accomplishments in serving Montana businesses. We continually strive to improve our operations, product selection, and pricing mechanisms to ensure Montana businesses and the community will continue to benefit from a strong Montana State Fund many years into the future.

Sincerely,

Carl Swanson

Carl Swanson
President/CEO